

INVESTABLE, GOVERNANCE-ENHANCED S&P 500 INDEX
THAT HAS BEEN BACK-TESTED FOR PERFORMANCE

Investing in companies with good governance can improve shareholder returns, as many have suspected for years.

This is no longer just a matter of intuition. It's a fact.

A study by Harvard Law School professor Lucian Bebchuk and his colleagues Alma Cohen and Allen Ferrell identified a statistically significant and strong correlation, over a long period of time, between stock performance and the degree to which boards are accountable to their shareholders.

Based on this research, Professor Bebchuk and Dr. Cohen, in collaboration with Glass, Lewis & Co., have developed a governance-enhanced S&P 500 index, the Board Accountability Index (BAI). The BAI consists of all companies in the S&P 500. It uses a modified market-cap weighting algorithm that adjusts a company's weight based on the presence or absence of five critical corporate governance features identified in the study of Bebchuk, Cohen, and Ferrell. At the same time, the algorithm seeks to maintain parity with the S&P 500 in terms of volatility and sensitivity to market-wide factors and thus ensure that the BAI closely tracks the S&P 500.

In extensive back-testing over the 14-year period from January 1, 1991 to December 31 2004, the BAI, while tracking closely the performance of the S&P 500, also:

- Outperformed the S&P 500 by an average of 55 basis points per year;
- Provided since 1991, an additional cumulative return of 30.9% (beyond that produced by the S&P500); and
- Outperformed the S&P 500 in a majority of the one-month, 3-month, 6-month, and 12-month periods.

KEY GOVERNANCE FACTORS

Compared with the S&P 500, the BAI underweights or overweights companies based on the presence or absence of the following:

- Staggered Boards
- Limits on shareholder bylaw amendments
- Poison pills
- Golden parachutes
- Supermajority requirements for mergers

Standard and Poor's has agreed to serve as the BAI's calculation agent and will make daily weightings and closing prices available on its platforms.

By controlling for elements other than the presence or absence of board accountability, the BAI offers institutions the opportunity to enhance returns by investing in good governance while tracking closely the S&P 500.

As shown in Table 1, BAI outperformed the S&P 500 in 12 of the last 14 calendar years.

TABLE 1

ANNUAL TOTAL RETURN			
Date	BAI Return	S&P 500 Return	Difference
1991	30.83%	30.46%	0.36%
1992	8.57%	7.62%	0.95%
1993	10.62%	10.08%	0.54%
1994	1.67%	1.33%	0.34%
1995	38.87%	37.58%	1.29%
1996	24.35%	22.95%	1.40%
1997	33.91%	33.36%	0.54%
1998	29.84%	28.58%	1.26%
1999	22.20%	21.04%	1.16%
2000	-9.60%	-9.12%	-0.49%
2001	-11.91%	-11.92%	0.01%
2002	-21.90%	-22.06%	0.17%
2003	29.05%	28.68%	0.36%
2004	10.63%	10.88%	-0.25%

INDEX METHODOLOGY

The BAI index is produced by underweighting companies with three or more entrenching provisions ("bad" companies) and overweighting companies with less than three such provisions ("good" companies). Specifically, the bad companies have their weight reduced by 75%, and the funds freed in this way are distributed among a "replacement portfolio" made of all the good companies. Notwithstanding the foregoing, the weights of companies with the ten largest market capitalizations in the S&P 500 are not adjusted. The weights of the good companies in the replacement portfolio are specified in accordance with an algorithm that seeks to ensure the redistribution of funds from bad companies to good companies will not significantly alter the portfolio's systematic risk characteristics. In particular, the algorithm seeks to ensure that (i) the replacement portfolio has the same correlation with market-wide movements (in particular, the four standard Fame-French-Carhart factors) as the portfolio of bad companies, while (ii) the distribution of weights is not too far from the relative weights of the good companies in the S&P 500. The algorithm produces a BAI index product that has similar systematic risk characteristics - that is, similar correlation with the four standard market factors - as the S&P 500.

Past performance and back-testing results are not necessarily indicative of future performance. The BAI could, from time-to-time and potentially for long stretches of time, earn returns lower than that of the S&P 500. The BAI is only available to qualified institutional buyers and should be studied carefully before any investment is made.

ABOUT GLASS LEWIS

Glass, Lewis & Co. is a leading investment research and proxy advisory firm, serving institutions that collectively manage more than \$8 trillion. Glass Lewis helps institutional investors make more informed investment and proxy voting decisions by identifying business, legal, governance and financial statement risks at more than 8,000 companies worldwide.

ABOUT LUCIAN BEBCHUK

Lucian Bebchuk is the William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance and Director of the Program on Corporate Governance at Harvard Law School. He is also a Fellow of the American Academy of Arts and Sciences, a Research Associate of the National Bureau of Economic Research, and an Inaugural Fellow of the European Corporate Governance Institute. Professor Bebchuk is widely recognized as one of the country's leading experts on corporate governance and its economic and financial consequences.

ABOUT STANDARD & POOR'S

Widely regarded as the best single gauge of the U.S. equities market, the S&P 500 includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the S&P 500 focuses on the large-cap segment of the market, with over 80% coverage of U.S. equities, it is also an ideal proxy for the total market. Standard & Poor's, a division of The McGraw-Hill Companies, is the world's foremost provider of independent credit ratings, indices, risk evaluation, investment research, data and valuations.

